

# Referee Report:

## Fiscal Monetary Services and Inflation

Submitted for publication to Macroeconomic Dynamics

### 1 Overview of the Paper

The paper investigates monetary services provided by government debt. In doing so, it develops a theoretical model and constructs a Fisher ideal index to measure these services. It then explores the nature of monetary services and finds that safety is a dominant priced attribute of government debt. Technical details and derivations seem correct to me. However, I believe that the paper needs to undergo a significant revision to make a clear and meaningful contribution to the literature.

### 2 Comments

1. It is stated that the model “expand[s] upon” the idea in Brunnermeier, Merkel and Sannikov (2022) that government debt constraints need to be augmented for the service flows (transaction/monetary services) that the securities provide. However, the mentioned paper actually states the opposite: money (as opposed to bonds) provides transaction services and therefore, nominal interest on money is less than on bonds.
2. The theoretical and empirical parts of the paper are somewhat disconnected. Instead of lending support to the developed theoretical model, the empirical section seeks to explore mechanisms that are not considered in the theoretical part. In particular, it examines what kind of monetary services is provided by government debt. It concludes that government debt provides mostly safety rather than liquidity services. The theoretical model allows for neither of these two: it has no default or liquidity premium. Note that a previous study by Krishnamurthy and Vissing-Jorgensen (2012), which estimates the price of safety, features corporate default.
3. The interpretation of Jorda projections for the prices of safety and liquidity (Figures 6 and 7) seems incorrect. The Baa–Aaa spread is the price of safety, and it increases during the first year following a shock. The paper states the opposite. The Aaa–10yr spread is the price of liquidity. It declines for longer horizons while the paper states that it increases. This misinterpretation leads the paper into a discussion of a “counter-intuitive” effect on liquidity and seeming contradiction to the results in Krishnamurthy and Vissing-Jorgensen (2012).
4. The paper states that treasury note–bond yield spread is likely to be explained by differences in liquidity. However, visually, there is little correlation between (differences of) series in

figures 1 (YTM) and 3 (bid-ask spread). Additional supporting evidence would be helpful here. If liquidity indeed is the driving force, why is it not included in the model?

5. I found the motivation and premises for the paper unclear. The title of the paper suggests that the focus of the paper is on inflation. However, the paper only returns to inflation at the very end. Then the introduction formulates multiple important research questions. However, it is difficult to follow them as the focus switches between the topics multiple times. The paper needs a better structure. I also suggest to formulate testable hypotheses and address them in a linear order. Supplemental findings can be moved to appendices.
6. The paper is premised on the assumption that government debt provides monetary/transaction services to its holders. Based on this assumption bond holdings are used as arguments of the utility function (similar to the money-in-utility model). Although a similar shortcut assumption have been used in the literature, it is worth discussing how government bonds facilitate transactions such that they enter households' utility together with consumption.
7. Since the paper seeks to disentangle the safety and liquidity services of government debt, I think the model should depart from Sidrauski's money-in-utility assumption which remains agnostic about how households extract utility from holding government debt. A model with a cash-in-advance constraint coupled with a corporate default mechanisms can potentially generate testable hypotheses on the importance of the liquidity and safety services, respectively. Then government bonds can be considered as a safe and liquid asset in a portfolio choice problem.